IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1941

No. .....

UNITED CONSTRUCTION COMPANY,
Petitioner,

vs.

G. SAM MILAM AND ROBERT M. COLEMAN, JR.,
TRUSTEES FOR DIAMOND ROCK ASPHALT CORPORATION,
Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINIONS OF COURTS BELOW.

The opinion in the District Court for the Western District of Kentucky is not reported but is set forth in full in the record at pages 38-41. The opinion of the Circuit Court of Appeals for the Sixth Circuit is copied at pages 54-57 of the record and is reported in 124 Fed. 2d 670.

II.

JURISDICTION.

1. The opinion of the Circuit Court of Appeals was filed January 10, 1942, and a petition for rehearing was denied April 6, 1942 (Rec. 65). The statutory provision which is believed to sustain the jurisdiction of this court is Section 240-A of the Judicial Code as amended by the Act of February 13, 1925 (U. S. C. A. Sec. 347-A). The jurisdiction of this court to review the cause by certiorari is sustained by:

Chicago Title & Trust Co. v. *Wilcox Building Corp.*, 302 U. S. 120.
Magnam v. *Coty*, 262 U. S. 159.162.

III.

STATEMENT OF THE CASE.

This is an application for a writ of certiorari for a review of the decree of the U. S. Circuit Court of Appeals for the Sixth Circuit affirming a decree of the U. S. District Court for the Western District of Kentucky.

The material facts and the questions involved are set forth in the preceding petition under I (PP 1-3) which is hereby adopted and made a part of this brief.

The question for decision is whether a vendor under a conditional sale agreement which recited that it was to be construed and governed by the laws of the State of Illinois where the property was located at the time of the execution of the said agreement, and which contract was valid in the State of Illinois without being recorded, can recover the property sold thereunder from the Trustees in Bank-

ruptcy of the buyer who had removed the property to the State of Kentucky, a state which required the conditional sale agreement to be recorded.

The contention of the petitioner is that it is entitled to the return of its property as against the Trustees in Bankruptcy of the buyer under said agreement.

IV.

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals erred:

1. In disregarding the petitioner's reliance on the point that a court of bankruptcy does not have jurisdiction over property sold under a conditional sale agreement and in not so holding.

2. In holding that insolvency of the buyer at the date of sale is not alone sufficient to vitiate the sale but that there must be proof of fraud.

3. In holding that the removal of the property sold under the conditional sale agreement from Illinois where an unrecorded agreement is valid to Kentucky where it is invalid gave the trustees in bankruptcy of the buyer rights over the property prior to those of the seller.

4. In holding in order to justify the priority of title of trustees in bankruptcy to the unpaid seller that a creditor who advanced credit subsequent to the execution of the conditional sale agreement was a subsequent creditor regardless of whether the property was in Illinois where the contract was admittedly valid or in Kentucky when such credit was advanced.

5. In affirming the order of the District Court.

V.

ARGUMENT.

SUMMARY OF THE ARGUMENT.

Point A.

In both a Section 77B proceeding and a Chapter X proceeding of the Chandler Act the powers of a Court of Bankruptcy are enumerated and such powers do not extend over property sold under a conditional sale agreement so that such property is excluded from the Court's jurisdiction.

Point B.

A Bankruptcy Court in a corporate reorganization proceeding has jurisdiction only over the debtor and its property. A conditional sale agreement being valid between the parties did not transfer the property sold thereunder to the debtor so as to give the bankruptcy court jurisdiction over it.

Point C.

When a purchaser buys property on credit and goes into bankruptcy within two months after the purchase and it is disclosed that he was hopelessly insolvent at the time of purchase, the transaction is presumptively fraudulent and the seller should be entitled to the return of its goods.

Point D.

The conditional sale agreement was valid in its inception and remained so even tho the property was removed from the State of Illinois to Kentucky, where (a) the agreement was not contrary to any public policy of the State of Kentucky; (b) the property was not immediately removed to the State of Kentucky, and (c) there was no

contemplation of the parties that the property should be removed to said state.

Point E.

In order for the trustees in bankruptcy to have priority over an unpaid seller under a conditional sale agreement, it was encumbent upon them to show that there was a subsequent creditor.

(a) Advancing credit subsequent to the date of execution of the conditional sale agreement does not constitute a creditor a subsequent one but it must be shown that he advanced the credit presuming that the property legally belonged to the buyer to whom the credit was so advanced.

(b) When credit was advanced to the buyer while the property sold under the conditional sale agreement was in the State of Illinois and the said agreement was valid as to all parties, the creditor was not a subsequent one in contemplation of law.

Point A.

In a corporate reorganization proceeding either under former Section 77B or under the present Chapter X of the Chandler Act the Bankruptcy Court is not given jurisdiction over property sold under a conditional sale agreement.

The reasoning given in the opinion in the Circuit Court of Appeals for the Second Circuit in the case of *In Re Lakes Laundry*, 79 Fed. (2d), 326, for holding that a court in a reorganization proceeding has no jurisdiction over property sold under a Conditional Sale Agreement is so cogent that we quote from page 328 of that decision as follows:

> "The fact that Congress expressly included the words 'Conditional Sale Agreement' in subdivision

(o) (6) of Section 75 of the Act, 11 U. S. C. A. Sec. 203 (o) (6), and omitted any reference to conditional sales in subdivision (c) (10) of Section 77B of the Act, 11 U. S. C. A. Sec. 207 (c) (10), is significant and points to the conclusion that it meant in this instance to exclude property in the possession of the debtor whose rights therein were only those of a conditional vendee. We should not ignore the distinction. *Quinn* v. *Bancroft-Jones Corporation*, 18 F. (2d) 727 (C. C. A. 2d).'"[1]

Certiorari was denied by this court in said case, in *Re Lake's Laundry*, 296 U. S. 622.

The holding in the instant case by the Sixth Circuit Court of Appeals is in direct conflict with the foregoing.

Point B.

A conditional sale agreement being valid between the parties does not pass title to the buyer so as to give a court of bankruptcy jurisdiction over such property when the buyer becomes a bankrupt.

The Circuit Court of Appeals for the Eighth Circuit in the case of *In Re Pointer Brewing Company*, 105 Fed. 2d, 478, decided a case exactly in point to the one here

1. The above argument should have added weight now. The Chandler Act was passed more than three years subsequent to the decision in the *In Re Lake's Laundry, Inc.* case. If Congress had simply overlooked the distinction in its enactment of Sec. 77B it could hardly have been an act of unintentional omission in the enactment of the Chandler Act. Yet the comparable sections in the latter retain the distinction. Subdivision (o) (6) of Sec. 75 of the 1938 Act, 11 U.S.C.A. 203 (o) (6), retains the words "conditional sale agreement" whereas sub-sec. 4 of Section 516 of the Chandler Act, 11 U.S.C.A. Section 516 (4) which replaced former section 207 (c) (10) still omits reference to a conditional sale agreement.

in issue. There a conditional sale agreement had not been acknowledged as required by Iowa law and consequently was invalid as against the "existing creditors or subsequent purchasers without notice." The court held however that since the conditional sale agreement was valid as between the parties, the title to the property remained in the vendor so that when the vendee filed its petition for reorganization the property covered by the conditional sale agreement was not the property of the debtor and hence did not pass to the trustee.

The Kentucky courts have held that a conditional sale agreement is valid as between the immediate parties even tho unrecorded.

Fry Brothers v. *Theobold*, 205 Ky. 146, 265 S. W. 498, 500.

Munz v. *National Bond & Investment Company*, 243 Ky. 293; 47 S. W. (2d) 1055, 1056.

Point C.

Aside from the express language of the conditional sale agreement retaining title in the seller, the undisclosed insolvent condition of the debtor at the time of the purchase of the barges vitiated the contract as conceived in fraud so for that additional reason title to the barges never passed to the debtor.

The Conditional Sale Agreement recited that it was made April 9, 1937, but the barges were not delivered until the early part of May, 1937. The balance sheet of the debtor corporation was filed with the stipulation (Rec. 34) showing its financial condition as of May 31, 1937 so that fewer than two months elapsed between the date of the contract and the date of the financial statement. It can be seen from the character of the financial statement itself that there could have been no appreciable difference in the financial condition of the debtor during April and May

of 1937. The liability sheet shows current liabilities in excess of $81,000.00, notes payable of $190,000.00, cash borrowed $43,000.00, and bonded indebtedness of $365,000.00; with a deficit in operation of over $9,000.00 for the two months of April and May, 1937. The asset sheet carries a development expense of approximately $91,000.00 and organization expenses of approximately $10,000.00 as assets; and then, in order to strike a balance with the liability sheet, puts an acquisition value on its properties at $1,500,000.00. Certainly it would not require an auditor's analysis to disclose the insolvency of this debtor on May 31, 1937; nor from the statement could it be said that this condition occurred "over night." The officers of the debtor corporation were charged with knowledge of the debtor's insolvency when the barges were purchased.

Aside from the consideration of any conditional sale contract, or question of lien, it may be stated as an independent proposition of law that where a buyer knows he is hopelessly insolvent and could have no reasonable prospect of being able to pay for goods purchased, there was no real meeting of minds between the parties so as to pass title under a valid contract. Such a purported sale may be rescinded and the goods recovered.

It has been held in other circuits that no evidence was necessary to prove fraud because under the circumstances appertaining in this case purchases made during insolvency are presumptively fraudulent.

Manly v. *The Ohio Shoe Company*, 25 Fed. (2d) 384, 385(5) (CCA 4).

In Re Gold, 210 Fed. 410 (CCA 7).

California Conserving Co. v. *D'Avanzo*, 62 Fed. 2d 528, 530(5) (CCA 2).

In Re Weismann, 19 Fed. 2d 769 (CCA 2).

Point D.

The conditional sale agreement should be governed by the laws of the State of Illinois as so provided by its terms.

If under all the conditions appertaining in this case justifying the operation of the Illinois Law, the law of Kentucky is allowed to supersede that of Illinois in fixing the rights of parties, there could easily be established a precedent which would dangerously restrict the mobility of personal property sold under any form of deferred payments. Situs of the property was in Illinois at the time the contract was executed (Rec. 22), the contract recited that it was to be construed and governed by the laws of the State of Illinois (Rec. 12), and the property was not removed from the State of Illinois with the express consent of the seller. The Circuit Court of Appeals took the position that knowledge of removal of property from one state to another without diligence to comply with the local law of record is equivalent to consent (Rec. 55), and cited Beale on Conflicts of Laws, Sec. 275.2 for its authority. The text in Beale is based on a 1928 decision rendered by the Supreme Court of the State of Washington and applies to bona fide purchasers. A better rule of law and one established by numerous decisions is not the length of time the property remains in the second state, but rather the interval between the execution of the contract and the removal of the property from the first state. This is the rule in the State of Kentucky where the Kentucky courts have said that if the property is to be *immediately* removed, then the instrument must be recorded in accordance with the Kentucky laws.

Fry Brothers v. *Theobold,* 205 Ky. 146; 265 S. W. 498, 500.

Johnson v. *Sauerman Bros., Inc.,* 243 Ky. 587, 49 S. W. (2d) 311.

The barges were not removed to Kentucky until more than a month had elapsed after the date of the contract which was over one-third of the total time between the date of the contract and the bankruptcy proceedings (Rec. 31-32).

Point E.

There was no showing by the trustees in bankruptcy that there was a subsequent creditor and their failure to make such a showing precludes them from any right to the property sold under the conditional sale agreement.

The stipulation between the parties recited that subsequent to April 9, 1937, the date of the execution of the Conditional Sale Agreement, credit in the amount of $35.27 was extended to the debtor (Rec. 37) and the Circuit Court of Appeals in its opinion stated that this was a concession that there was a subsequent creditor (Rec. 56). The same court in another case has held that it was encumbent upon the Trustees of Bankruptcy to show that there was a subsequent creditor.

National Bond & Investment Company v. *Jones*, 78 Fed. (2d) 601.

While the property was in the State of Illinois the agreement was valid (Rec. 22, #4) so that any one advancing credit during that period secured no lien upon the property. A subsequent creditor is one who advances or may be presumed to have advanced credit on the assumption that the one to whom he advanced it was the owner of the property.

Holt v. *Crucible Steel Company*, 224 U. S. 262.

Wicks v. *Connell*, 102 Ky. 434.

In our case it was legally impossible to presume that this $35.27 creditor advanced the credit upon the faith of the debtor's ownership of the barges while those barges were in Illinois. Yet to sustain their priority the trustees must, under the holding of *National Bond & Investment Company* v. *Jones, supra,* show that credit was advanced upon the faith of the debtor's ownership of said barges.

The stipulation then that there was a creditor who advanced credit subsequent to the date of the agreement, does not satisfy the burden of proof encumbent upon the trustees to show that there was a subsequent creditor. It would need to be shown that such creditor advanced credit after the barges were removed to Kentucky so that by holding that there was a subsequent creditor under the conditions of the stipulation the Circuit Court of Appeals has set a precedent contrary to the cases herein cited that there must be a presumption of ownership on the part of the purchaser of the property.

CONCLUSION.

It is therefore respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, by granting a writ of certiorari and thereafter reviewing and reversing said decision.

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